FILED
MAR 23 1943
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 846

MAGNUS BECK BREWING COMPANY, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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INDEX.

Subject Index.

	Page
Petition for writ of certiorari	1
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and regulations involved	2
Statement	2
Specification of errors to be urged	5
Reasons for granting the writ	6
Conclusion	7
Appendix—Statutes and regulations involved	8
Brief in support of petition	12
Statutes and regulations involved	12
Statement (see petition)	12
Question presented	12
Argument	12

Table of Cases Cited.

C. C. Clark, Inc., v. *The United States*, 126 F. (2d) 292	5, 6, 14
Clover Splint Coal Co. v. *Commissioner*, 130 F. (2d) 52	6, 13
Commissioner v. *Michigan Silica Company*, 124 F. (2d) 397	6, 12
Helvering v. *Moloney Electric Co.*, 120 F. (2d) 617	5, 6, 13
Helvering v. *North West Steel Rolling Mills*, 311 U. S. 46	5, 15
Nevada-Massachusetts Co. v. *Commissioner*, 128 F. (2d) 347	5, 6, 14

Statutes Cited.

Judicial Code, Sec. 240(a), as amended	2
Revenue Act of 1936, Sec. 26(c)(2), c. 690, 49 Stat. 1648	2, 4, 5, 6, 7, 8, 12, 14

Regulation.

Treasury Regulations 94	6

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

The petitioner, Magnus Beck Brewing Company, Inc., by its attorneys, Garono, Jaeckle & Kelly, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit in the above cause reversing the decision of the Tax Court and reinstating assessment against petitioner.

Opinions Below.

The Tax Court promulgated an opinion on January 14, 1942, reported in 46 B. T. A. 78. The Court below rendered an opinion on December 7, 1942, reported in 132 F. (2d) 379 (R. 44).

Jurisdiction.

The judgment of the Court below was entered on December 30, 1942 (R. 47). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

Where a taxpayer corporation threatened with bankruptcy enters into a written contract with the trustee for its creditors requiring said taxpayer to pay to such trustee a stated amount upon the sale of each unit of its sole product and commodity sold by it during each week, is the contract so entered into one which "expressly deals with the disposition of earnings and profits of the taxable year" within the meaning of Section 26 (c) (2) of the Revenue Act of 1936?

Statutes and Regulations Involved.

The Statutes and Regulations involved are set out in the Appendix, infra, pp. 8-11.

Statement.

The taxpayer is a corporation organized in 1932 under the laws of the State of New York and engaged in the brewing industry. By January, 1934, it had become financially involved, being unable to meet its obligations as they matured (R. 23). The solution to this situation took the form of a trust agreement wherein the taxpayer promised to pay each week to a trustee $1 "upon each barrel of beer sold by it" during the previous week. The trustee in turn was required to use this fund to pay the creditors in accordance with an agreed plan of priorities (R. 10-17, 24). The per-

tinent provisions of this trust agreement are as follows (R. 24):

> Third: The Corporation specifically agrees to pay to the Trustee, beginning April first, 1934, and until the expiration of this agreement, a stated amount upon each barrel of beer sold by it as hereinafter set forth, such payments to be made on or before Wednesday of each week for all beer sold by it during the previous Calendar Week, the first of such payments to be made on or before Wednesday, April 11, 1934; the rate per barrel to be paid by the Corporation to the Trustee shall be as follows:
>
> Fifty cents (50¢) per barrel, on all beer sold during the months of April and May, 1934, and One Dollar ($1.00) per barrel on all beer sold thereafter.
>
> Fourth: It is mutually understood and agreed that the Trustee shall have the right to waive any such weekly payment required to be made to him by the Corporation if he shall deem such waiver expedient and necessary, but any such waiver shall in no wise operate as a waiver of any other or further payment required to be made by the Corporation to said Trustee.
>
> * * * * * * *

The amount of $1 per barrel to be paid under the terms of the trust agreement was fixed by the trustee and accountants for the taxpayer after going over the sales of taxpayer for the month prior to the execution of the contract as an estimate of the profit taxpayer would make on each barrel produced and sold, if business conditions were prosperous (R. 25).

The following weekly payments were made to the trustee by the taxpayer in 1934, 1935 and 1936 (R. 25):

	1934		1935		1936	
	Payments to trustee	Barrels sold	Payments to trustee	Barrels sold	Payments to trustee	Barrels sold
January		2,063.50	$1,669.19	3,348.00	$1,870.00	3,508.00
February		1,729.00	1,605.20	3,360.25	1,981.50	3,514.50
March		2,559.00	1,863.62	4,442.75	1,893.00	4,276.75
April	$1,231.25	2,947.00	2,487.36	4,423.75	3,593.50	4,377.00
May	2,535.99	4,004.75	2,130.12	4,762.50	4,776.00	5,590.75
June	4,341.87	5,140.75	4,860.50	5,456.00	6,997.00	6,291.50
July	6,909.00	5,811.00	7,244.50	6,737.75	6,893.00	7,496.25
August	5,134.39	5,955.75	7,438.75	6,794.50	8,254.00	7,334.50
September	4,217.29	3,959.00	4,877.00	4,649.50	6,003.00	6,132.25
October	3,909.76	4,073.75	4,343.25	4,825.25	5,071.98	5,766.75
November	1,838.92	3,922.75	4,426.00	4,696.25	.....	4,973.25
December	659.35	3,867.00	5,626.00	4,149.75	.....	5,485.25
Total	30,777.82	46,033.25	48,571.49	57,646.25	47,332.98	64,746.75

The business of the taxpayer was seasonal and during the last two months of 1936, which was its off season, it was allowed by the trustee to reduce "payment to what we were able to pay." The taxpayer had an oral understanding with the trustee that it should pay its indebtedness from earnings. By virtue of the payments on account of beer produced and sold from 1934, the indebtedness secured by the trust agreement was completely paid off during 1937 and the assets of the company were thereafter free of these liabilities (R. 25).

The annual profits of the taxpayer, together with the barrels of beer sold and profits per barrel, upon an annual basis from 1933 to and including 1939, were as follows (R. 25-26):

	Profits for year	Barrels sold	Profit per barrel
1933	$2,052.05	13,014.25	$0.16
1934 loss	6,805.46	46,033.25	.15
1935	50,608.31	57,646.25	.88
1936	60,415.96	64,746.75	.93
1937	47,149.29	74,148.75	.63
1938	17,246.93	70,674.50	.24
1939	2,621.53	70,018.75	.04

In computing the surtax on undistributed profits imposed by the Revenue Act of 1936, the taxpayer claimed a credit under Section 26 (c) (2) of $47,332.98, being the total payment made to the trustee in that year. The Commissioner of Internal Revenue determined that this credit

should not be allowed and proposed to assess the resulting tax deficiency (R. 26). The Board of Tax Appeals held, however, that the taxpayer was entitled to the credit claimed and that the proposed deficiency was erroneous to the extent that such credit had not been allowed (R. 27). A small deficiency was entered against the taxpayer upon uncontested issues (R. 28).

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that Section 26 (c) (2) should not be construed according to its underlying purposes, viz, the intent of Congress to grant a credit to corporations for moneys paid during the taxable year under written contracts which prevented accumulations of earnings and profits.

2. In holding that the Court must look to the written contract alone and disregard the financial situation of the taxpayer at time contract was made and at time of performance as the basis for credits allowed by Section 26 (c) (2).

3. In holding that the Commissioner is not obliged to examine the taxpayer's business and decide how much of what the contract calls for taxpayer could not avoid paying out of current earning and profits.

4. In holding that the taxpayer could have paid its obligations under its contract from any source other than its earnings on the sale of its sole product.

5. In holding that the situations in *Helvering* v. *Moloney Electric Co.*, 120 F. (2d) 617 (8th C. C. A.); *C. C. Clark, Inc.* v. *The United States*, 126 F. (2d) 292 (5th C. C. A.); *Helvering* v. *North West Steel Rolling Mills*, 311 U. S. 46; and *Nevada-Massachusetts Co.* v. *Commissioner*, 128 F. (2d) 347 (9th C. C. A.), were analogous to the case at bar and controlling.

6. In holding that *Commissioner* v. *Michigan Silica Company,* 124 F. (2d) 397 (6th C. C. A.), and *Clover Splint Coal Co.* v. *Commissioner,* 130 F. (2d) 52 (3 C. C. A.), were to be disregarded since payments therein were "flat within" the Treasury Regulations 94.

7. In reversing the Tax Court which held that since all payments made by taxpayer under its contract in question had to come from receipts of sale of beer (it had no other available funds) they necessarily included "earnings and profits of the taxable year" if there were any and that this satisfied Section 26 (c) (2).

Reasons for Granting the Writ.

As recognized by the Circuit Court of Appeals, the contentions of taxpayer were successful in the Second and Third Circuits. *Commissioner* v. *Michigan Silica Company,* 124 Fed. (2d) 397 (C. C. A. 6) and *Clover Splint Coal Co.* v. *Commisioner,* 130 Fed. (2d) 52 (C. C. A. 3). However, the Second Circuit in its opinion dismissed the conclusions reached in said cases with the statement that the payments for each ton of sand sold in the Michigan Silica case and for each ton of coal mined in the Clover Splint Coal Co. case were "flatly within Article 26-2 (c) (3) of Treasury Regulation 94".

The Circuit Court cited in support of its findings *Helvering* v. *Moloney Electric Co.* 120 Fed. (2d) 617 (C. C. A. 8); *C. C. Clark, Inc.* v. *United States,* 126 Fed. (2d) 292 (C. C. A. 5); *Nevada Massachusetts Co.* v. *Commissioner,* 128 Fed. (2d) 347 (C. C. A. 9). In all of these cases there was a clear cut distinction from the situation in the instant one. The said cases support the contention advanced by this petitioning taxpayer. The decisions in said cases are seemingly based on the very features which distinguish said cases from the instant one.

"The limited words of the Section (26 (c) (2)) were chosen deliberately and although they should not be read

in entire disregard of the background of the general purposes, they were certainly not intended to execute that purpose completely" (extract from Circuit Court's opinion in instant case). In these words the Circuit Court of Appeals recognized the validity of taxpayer's contention that the purpose of the Section 26 (c) (2) must have as important a part in allowing credits as the actual wording of the section.

Helvering v. *Northwest Steel Mills*, 311 U. S. 46 involved a deficit corporation of the State of Washington and was decided on the question that there was not a written contract restricting dividends as provided by Section 26 (c) (1); reference to Section 26 (c) (2) was merely on a comparative basis as to necessity of a "written contract".

Conclusion.

The question herein presented has not been passed on by this Court. The Circuit Courts have obviously reached different interpretations of Section 26 (c) (2). Credits to taxpayers on undistributed profits taxes are of such importance today as to call for review of the question herein presented. It is, therefore, respectfully submitted that this petition for Writ of Certiorari be granted.

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